

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
PRABHU AND KISHWAR HEMRAJANI	:	
for Redetermination of a Deficiency or for	:	DETERMINATION
Refund of Personal Income Tax under Article 22	:	DTA NO. 807994
of the Tax Law for the Years 1985 and 1986.	:	

Petitioners Prabhu and Kishwar Hemrajani, 4026 Pawnee Drive, Liverpool, New York 13090 filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1985 and 1986.

A hearing was held before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, 333 East Washington Street, Syracuse, New York, on January 9, 1992 at 9:15 A.M. Petitioners filed a brief at the hearing. The Division of Taxation filed a brief on February 27, 1992. Petitioners filed a reply brief on April 9, 1992. Petitioners appeared by Bond, Schoeneck & King, Esqs. (Jeremiah P. Cosgrove, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Mark F. Volk, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly used a source and application of funds method of income reconstruction on audit herein.

II. Whether, if so, petitioner has met his burden of proving error in the audit method or result.

FINDINGS OF FACT

On December 23, 1988, following an audit, the Division of Taxation ("Division") issued

to petitioners, Dr. Prabhu Hemrajani and Kishwar Hemrajani,¹ a Notice of Deficiency which assessed \$3,429.35 in additional personal income tax due, plus penalty pursuant to Tax Law § 685(b) and (c) and interest, for the years 1985 and 1986.

By a Statement of Audit Changes dated October 7, 1988, the Division set forth its computation of the subject personal income tax deficiency summarized as follows:

	<u>1985</u>	<u>1986</u>
Additional Income per Source and Application of Funds Audit	\$17,904.00 ²	\$16,650.00
Disallowed Business Expenses	<u>1,626.00</u>	<u>(305.00)</u>
Net Adjustment	\$19,530.00	\$16,345.00
Taxable Income Previously Reported	<u>41,664.00</u>	<u>20,016.00</u>
Taxable Income Per Audit	\$61,194.00	\$36,361.00
Tax on Above	\$ 5,288.23	\$ 2,901.12
Tax Previously Reported	<u>3,428.00</u>	<u>1,332.00</u>
Additional Tax Due	\$ 1,860.23	\$ 1,569.12

Pursuant to a Conciliation

Order dated December 29, 1989, the total deficiency of tax herein was reduced to \$3,273.81, plus penalty and interest. This adjustment resulted from the correction of a duplication of the Division's disallowance of a business expense of \$1,626.00 for 1985.

This adjustment reduced the deficiency for 1985 to \$1,704.69 and reduced the total deficiency as noted above.

Petitioner is a dentist engaged in the practice of dentistry in Liverpool, New York. During 1985 and 1986, petitioner's practice was in the form of a sole proprietorship under the name Bayberry Dental Center.

¹Kishwar Hemrajani is a petitioner herein solely by reason of having filed a joint return with Dr. Prabhu Hemrajani during the years at issue. Petitioners are no longer married and Kishwar Hemrajani currently resides in India. Accordingly, all references to petitioner herein, unless otherwise indicated, shall refer to Dr. Prabhu Hemrajani.

²This figure erroneously includes \$1,626.00 of disallowed business expenses. This error was corrected by the Conciliation Order (see Finding of Fact "3").

As noted above, the Division determined additional tax due based on the results of a source and application of funds audit. Upon review of certain of petitioner's tax returns and records, the Division determined total sources of funds for 1985 and 1986 of \$98,455.00 and \$157,277.00, respectively. The Division also determined total applications for 1985 and 1986 of \$114,733.00 and \$174,232.00, respectively. Applications thus exceeded sources by \$16,278.00 for 1985 and \$16,955.00 for 1986. The Division considered these amounts additional taxable income and calculated the deficiency herein accordingly.

Included among the applications of funds were personal living expenses of \$45,000.00 for 1985 and \$40,000.00 for 1986. Such personal living expenses were determined by totaling petitioner's actual personal expenditures made by cash, check or money order during 1985 and 1986 and by adding to that amount certain estimated cash expenditures for food, gifts, entertainment, travel, clothes and other miscellaneous expenses. In its workpapers setting forth its calculations of petitioner's personal living expenses for each year, the Division listed \$10,000.00 in such estimated cash expenses for each such year. Using this \$10,000.00 figure, the Division's workpapers indicate \$44,424.00 in total personal living expenses for 1985 and \$38,515.00 in total personal living expenses for 1986. As noted, however, the Division used the personal living expense figures of \$45,000.00 and \$40,000.00 in calculating petitioner's total applications for the years at issue. The Division thus rounded its calculation of petitioner's personal living expenses upward by \$576.00 for 1985 and by \$1,485.00 for 1986 in calculating petitioner's total applications for the years at issue.

On its workpapers setting forth its calculations of petitioner's personal living expenses, the Division listed no purchases by check or money order for clothing, food, dining out or entertainment for 1986 and a total of \$318.00 in such purchases for 1985.

During 1985 and 1986,

petitioner, although filing a joint return, did not reside with Kishwar Hemrajani. Petitioner did reside with Salena Bennett. During this period, Ms. Bennett was employed full time by petitioner in his dental practice as an office manager. Her responsibilities included bookkeeping. Ms. Bennett's total salary for the years 1985 and 1986 was about \$4,000.00.

The records reviewed by the Division on audit revealed that Ms. Bennett transferred \$2,000.00 to petitioner by check in 1985. Petitioner's records also revealed a subsequent transfer during 1985 of \$6,000.00 from petitioner to Ms. Bennett. The Division included this \$6,000.00 as an application of funds for petitioner for 1985, and on its workpapers listed this transfer as a payment of a loan to Ms. Bennett in accordance with petitioner's statement to the Division on audit. The Division did not, however, consider this transfer to be, in fact, a loan repayment.

To document the existence of purported loans totaling \$6,000.00 from Ms. Bennett in 1985, petitioner introduced certain bank deposit receipts indicating deposits during 1985 into petitioner's business account of \$4,000.00, \$2,000.00 and \$4,119.90. The receipts did not further identify the deposits.

To document the existence of purported loans from his brother and mother, petitioner offered documents purporting to be the functional equivalent of affidavits executed in India. By her affidavit petitioner's mother stated that she had given petitioner a "loan" of \$9,000.00 during her visit in 1985. By his affidavit, petitioner's brother stated that he had given petitioner a "loan" of \$8,500.00 during his visit in 1986.

To establish that he maintained complete and accurate records of his dental practice petitioner submitted samples of records of individual patients which indicated treatment, charges and payment histories which petitioner maintained during the audit period. The Division did not review such records on audit.

SUMMARY OF PETITIONER'S POSITION

Petitioner contended that the

books and records of his dental practice were complete and that such records accurately reflected the revenues and expenses of his business. Petitioner further contended that the Division improperly failed to examine the records of his business in its determination of additional tax due herein.

Petitioner contended that when his mother visited him for about three months in 1985, she brought with her approximately \$10,000.00 in United States currency which she used during her stay to buy gifts for petitioner, pay for petitioner's household expenses and to travel with petitioner within the United States while paying for petitioner's travel expenses. Petitioner contended that at the end of her stay, his mother gave him the remainder of her cash, totaling about \$3,000.00, before she returned to India.

Petitioner contended that when his brother visited him in 1986, his brother brought with him approximately \$13,000.00 to \$14,000.00 in United States currency which petitioner's brother used during his stay to purchase gifts for petitioner, pay for petitioner's household expenses and to travel with petitioner within the United States while paying petitioner's travel expenses. Petitioner contended that at the end of his stay, his brother gave him the remainder of his cash, about \$4,000.00, before returning to India.

Petitioner maintained that the removal of United States currency from India in the amounts described above was illegal. Petitioner also contended that it was illegal to enter India with the amounts of cash given to petitioner by his mother and brother prior to their return to India.

Petitioner argued that the \$2,000.00 check transferred to him by Salena Bennett in 1986 constituted a loan. Petitioner also contended that Ms. Bennett loaned him an additional \$4,000.00 during 1986 and that the \$6,000.00 transfer from petitioner to Ms. Bennett during 1986 constituted a repayment of such loans from Ms. Bennett. The source of this claimed \$4,000.00 loan was purportedly a safe

deposit box maintained by Ms. Bennett.

CONCLUSIONS OF LAW

A. Petitioner's contention that the Division's use of the source and application method of audit was improper under the circumstances herein is rejected. Contrary to petitioner's contention, the Division was not required to establish the inadequacy of petitioner's records before resorting to the source and application audit method.

"[A]n initial consideration of inadequate or incomplete books and records before employing an indirect method is normally only required in sales and use tax cases where the tax is imposed upon verifiable receipts evidenced by statutorily required books and records." (Matter of Giuliano v. Chu, 135 AD2d 893, 521 NYS2d 883, 886, citing Matter of Hennekens v. State Tax Commn., 114 AD2d 599, 494 NYS2d 208, 209; see also, Matter of Lee, Tax Appeals Tribunal, October 11, 1990.)

B. Petitioner has failed to meet his burden of proof imposed under Tax Law § 689(e) to show the existence of nontaxable sources of funds in the form of gifts or loans from his mother in 1985 and his brother in 1986. The proof submitted to support this contention is insufficient in many ways.

First, the purported transfers were completely undocumented since the transfers were in cash and no cancelled checks exist to document the transfers. Further, the record contains no documentation of bank account deposits by petitioner of amounts purportedly received. Second, the amounts of the purported loans are estimated. Petitioner contended that his mother and brother spent money on his behalf for gifts, household expenses and travel expenses. There is no documentation in the record as to these purported expenditures. Additionally, petitioner contended that, before his mother and brother returned to India, each gave him approximately \$3,000.00 to \$4,000.00. That petitioner is even uncertain as to the amount of cash given to him on these occasions underscores the speculative nature of these contentions. Finally, since, according to petitioner, the removal of United States dollars from India is illegal, to accept petitioner's contention it must also be concluded that petitioner's mother and brother illegally smuggled United States currency out of India. This also weighs against petitioner's contentions.

In sum, considering that the transfers in question were completely undocumented, the fact

that petitioner has not established with any degree of precision the amount of the purported loans, and the fact that petitioner's mother and brother would have had to illegally remove United States currency from India all weigh against petitioner's contentions and compel the conclusion that petitioner has not met his burden of proof with respect to these contentions.

C. Regarding the claimed \$6,000.00 in loans to petitioner from Ms. Bennett, the record establishes that petitioner received \$2,000.00 by check from Ms. Bennett during 1985. The Division contends that this \$2,000.00 transfer should not be included as a source of funds for petitioner since petitioner has not shown Ms. Bennett's source of this money. The Division's contention is rejected. The record shows that a transfer to petitioner occurred. If petitioner transferred funds to Ms. Bennett prior to the \$2,000.00 transfer (and during 1985), then the Division's audit should have discovered such transfers and listed such transfers as applications of funds for 1985. No such transfers were discovered on audit. The Division's contention that petitioner may have transferred funds to Ms. Bennett is thus mere speculation unsupported by the results of the Division's own audit. Accordingly, the Division improperly failed to allow the \$2,000.00 transfer from Ms. Bennett to petitioner in 1985 as a source of funds on audit herein.

D. With respect to the claimed \$4,000.00 transfer from Ms. Bennett to petitioner, there is no cancelled check to establish that such a transfer did, in fact, occur. In the absence of such documentation, it is concluded that petitioner has failed to establish the existence of the purported \$4,000.00 transfer from Ms. Bennett to petitioner. It is noted that the testimony regarding the source of this \$4,000.00 (i.e., the safe deposit box) presented in support of petitioner's contention was insufficient to overcome the lack of documentation regarding the existence of this transfer. It is further noted that the deposit ticket entered into the record lends little support to petitioner's contention since the ticket establishes only that there was a deposit. The ticket in no way identifies the deposit. Accordingly, the Division's disallowance as a source of funds of the claimed \$4,000.00 transfer from Ms. Bennett to petitioner was proper. It is further noted that, considering the relationship between Ms. Bennett and petitioner and the meager wages paid to Ms. Bennett during 1985, the fact that petitioner transferred \$6,000.00 to

Ms. Bennett in 1985 does not establish that such payment represented repayment of a loan.

E. Petitioner also contended that the Division's calculation of petitioner's personal living expenses was excessive. The only specific component of the personal living expenses contested by petitioner was the Division's estimate of \$10,000.00 of cash living expense for each of the years at issue. While petitioner contended that this estimate was excessive, petitioner offered no evidence as to his actual cash living expenses during those years, nor did petitioner offer any evidence regarding his personal lifestyle during 1985 and 1986. Under such circumstances, it is concluded that the Division's estimates were reasonable.

F. Petitioner correctly argues, however, that the Division improperly increased its calculation of petitioner's personal living expenses by simply rounding its calculations upward (see Finding of Fact "6"). The Division's workpapers indicate personal living expenses for the years at issue of \$44,424.00 and \$38,515.00, respectively, and not \$45,000.00 and \$40,000.00 as used by the Division in calculating additional tax due. Accordingly, the Division is directed to adjust its calculations of additional taxable income for 1985 and 1986 by \$576.00 and \$1,485.00, respectively, in order to properly reflect the Division's calculation of petitioner's personal living expenses as set forth in the Division's own workpapers.

G. The petition of Prabhu and Kishwar Hemrajani is granted to the extent indicated in Conclusions of Law "C" and "F"; the petition is in all other respects denied. The Division is directed to modify the Notice of Deficiency issued December 23, 1988 accordingly. Except as so modified, the Notice of Deficiency, as adjusted by the Conciliation Order, dated December 29, 1989, is sustained.

DATED: Troy, New York
November 12, 1992

/s/ Timothy J. Alston
ADMINISTRATIVE LAW JUDGE